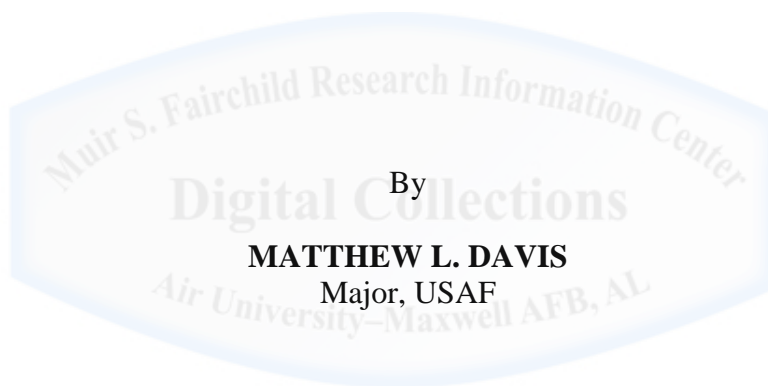


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AIR COMMAND AND STAFF COLLEGE

AIR UNIVERSITY

**FUNCTIONALISM  
AND  
THE KAESONG INDUSTRIAL COMPLEX**



A Research Report Submitted to the Faculty

In Partial Fulfillment of Graduation Requirements

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## **ABSTRACT**

Functionalist international relations theory provides a useful framework for building foreign policy for peace. In 2010, North Korea allegedly sunk the South Korean warship “Cheonan.” Surprisingly, international economic activity between North and South Korea continued despite high political tension in which trade between the nations had “officially” ceased. The mechanism for this continued engagement was the Kaesong Industrial Complex: a joint commercial enterprise between North and South Korea that effectively implements functionalist theory and offers a hope for peace.

In 1998, years of geographic and political division combined with unique economic and political conditions to enable this joint business enterprise in Kaesong. At least two South Korean presidential administrations intentionally developed functional ties with North Korea to facilitate unifying the fractured country. South Korea’s tactical pragmatism provides an opportunity for great strategic gain. By applying functionalism, South Korea aids the North Korean economy while providing a resilient venue for peace. The Kaesong Industrial Complex remained open despite North Korean ballistic missile tests, nuclear detonations and the occasional armed hostilities that closed all other connections. A commercially viable enterprise, Kaesong also relieves political pressure. The Kaesong Industrial Complex reintroduced human rights actions, legal reforms, free trade and political changes in North Korea that wouldn’t have otherwise been possible. By improving Korean security, Kaesong helps build favorable conditions for future unification. The Kaesong Industrial Complex showcases the opportunities and limitations of functionalist foreign policy.

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### **Introduction**

Civilization north of Seoul decreases by inverse proportion to barbed wire. Palpable tension lingered as I toured the Korean demilitarized zone (DMZ) two months after North Korea killed 46 sailors and wounded another 56 by sinking a South Korean warship. My DMZ tour ended with a sprawling industrial complex emerging before us. A new highway and railroad brought commerce north to a visible collection of factories, and presumably on to Pyongyang. Vehicles moved and commerce crossed the border. Strict regulations banned Bibles and moon pies, but millions of US dollars flowed freely north each month...in cash.

Didn't war still cloud Korea? What was this enterprise and why did it exist? Known as the Kaesong Industrial Complex (hereafter referred to as the KIC or Kaesong), this political dichotomy was built from functionalist international relations theory to produce economic and political dividends.

### **Functionalism**

Functionalist international relations theory grew following WWI but, existed in reformist ideology since 1870.<sup>1</sup> Explained by Romanian political scientist David Mitrany, functionalism transcends international power politics with administrative cooperation. The theory advances functional interdependence between people, groups or nations. Ranging from blacksmithing guilds to the International Labor Organization (ILO), functional relationships theoretically supersede national interests and transform the international power dynamic according to the practical requirements of each function.<sup>2</sup>

Functionalism presupposes "man is by nature good, rational, and devoted to the common weal; when society is organized so as to bring out man's tendency to mobilize his energies for the general welfare, the forces of peace and harmony rule."<sup>3</sup> This energy for the general welfare arises not from government, but rather by a "maximum of authority exercised by technicians and

administrators dedicated to the common weal, working in close conjunction with the voluntary professional groups that form part of any modern industrial society...The functionalist would hold that the human condition will improve only when “the government of men is replaced by the administration of things.”<sup>4</sup> Pure functionalists reject liberal politics and prefer to separate technical tasks from political government.<sup>5</sup>

They view the cooperative national effort which pursues a negative security goal or “law and order” as uncreative. Instead, functionalists find creativity in welfare. Ernst Haas, in his treatise Beyond the Nation-State, claimed that redefining “rights flowing from an expanding welfare concept is a creative task still possible to the state.”<sup>6</sup> When the functionalist wants peace, he stresses creative elements and functional work by replacing the negative political with positive, functional connections.<sup>7</sup> Functionalists seek not a static peace, but a working peace by creatively knitting together social networks based on common interests. The functionalist avenue to peace, according to Haas, starts with the “reintroduction of man, united in natural occupational groupings that ignore territorial boundaries, functioning through voluntary associations dedicated to welfare measures on which there is general agreement. This is the creative solution.”<sup>8</sup>

Functionalists also believe domestic peace through social welfare can be extended internationally.<sup>9</sup> Functionalists alleviate international conflict by increasing social welfare through the work of technical experts, specialists, and their professional associations. Experts, uncorrupted by power, could reach agreement when statesmen would fail.<sup>10</sup> Peace, then, results from national reforms that maximize functional interests. Converging, technical interests would eventually lead to nations being “federated by the force of things.”<sup>11</sup>

Interests, to the functionalist, need not be “reconciled” if they can be “integrated” through a working effort. To achieve this working effort, functionalists have four basic propositions. First, power must be separated from welfare; second, government activities should be divided by function with all government activities being “coterminous” with welfare and that lessons learned from welfare are transferrable between communities; third, there must be distinctions between the political and technical, the politician and the expert, and “the wholesome work of the voluntary group and the circumspect actions of the government and that welfare is best achieved by technical experts;” and finally fourth, functionalists believe loyalties are created by the satisfaction of needs by a function in hierarchical supremacy to nationalism.<sup>12</sup> Functionalists believe a person’s loyalty will transfer to an international organization if that organization more sufficiently meets his needs than his national government.<sup>13</sup>

### **Historical Division and Unification Planning**

Functionalist theory emerged in Korea under colonialism and expanded during the years of political and military stalemate since a 1953 armistice ended the Korean War. Tied to unity and nationalism, functionalism helped this homogenous state keep their strong, distinct identity: “one race, one culture and one language.”<sup>14</sup> During colonization, Japan did not attempt to change Korea’s traditional geographic boundaries.<sup>15</sup> Instead, Japan pursued different development strategies for North and South Korea. Japanese capital investment created a specific industrial distribution along the peninsula with natural resources fueling heavy industry in the north. Less Japanese money went to the south, which developed textiles and required lower labor costs.<sup>16</sup> Economic investment linked Korea to Japan in a functional relationship.<sup>17</sup> The Japanese saw Korea as a regionally separated industrial location providing a logistics base for Japanese exploitation of Asia. Colonization formed Korea as a specialized manufacturing

and mining hub for exports.<sup>18</sup> Thus began the diverging, geographical Korean development that continued politically when the United Nations divided Korea into two separate regions and governments after WWII.<sup>19</sup> Geographically based development and political division led to both Koreas pursuing different political, social and economic paths.<sup>20</sup>

These developmental paths widened over the years as North Korea used communist economic planning to promote heavy industry and fund huge military expenditures while South Korea invested in smaller industry with help from the West.<sup>21</sup> Prevailing thought in 1973 was that “sustained economic development would tend to transform the (North Korean) Stalinist command economy into one that is more liberalized and decentralized.”<sup>22</sup>

Potential for cooperation existed in 1973 when South Korean state-owned monopolies resembled state controlled operations in the North.<sup>23</sup> Transforming North Korean worker cooperatives into corporations with a Yugoslav style Worker’s Council for transitional management of small to medium sized industry was seen as a way to de-collectivize. The resulting movement in labor and resources throughout a unified Korea might have created structural changes in the North Korean economy and labor force.<sup>24</sup> These complimentary institutions could have facilitated economic Korean unification;<sup>25</sup> however, the political will for unification did not yet exist.

South Korea expects North Korean cooperation to facilitate unification and believes that:

“(between market and command oriented economic systems) economic development and industrialization, because of their own modus operandi, complexity and diversity along with the changing consumption pattern due to affluence, will lead the two systems to converge somewhere in the middle.”<sup>26</sup>



The South and North Korean economies may be more compatible today. Though the North Korean economy diverges from the South, thirty years of South Korean industrial development has created the potential for heavy industry cooperation. South Korean hope remains in the economic power to reform political ideology.

Former South Korean president Kim, Dae-jung's "Sunshine Policy" with North Korea put functionalist theory into action. A political activist, economist and author of over thirty books, Kim Dae-jung wrote his unification plan in a book published one year prior to his inauguration titled "Three-Stage" Approach to Korean Reunification: Focusing on the South-North Confederal State. Based on a three-staged process, unification began by confederating into one nation, two states and two independent governments. Next, a federation would form consisting of one nation, one state, one system and two autonomous regional governments. The third and final stage completed unification by recreating one nation with centralized government or a federated state similar to the United States or Germany.<sup>27</sup> President Kim planned to build a National Economic Community to facilitate building the confederation. With business being the central function, Kim Dae-jung lent structure to his plan by using the four functionalist tenets. While a catalyst for cooperation, he attempted to separate politics from economics.<sup>28</sup> Kim began building a functional link between South and North Korea by focusing government assistance to small and medium businesses and gave political consideration for North Korea's open doors. He used the tenets of functionalism not only to expand cooperation, but to also attract foreign direct investment.<sup>29</sup>

Adhering to the first functionalist tenet, Kim Dae-jung kept government out of business by creating investment in "free economic trade zones." This cooperation could advance welfare, and the second functionalist tenet, by jointly developing tourist areas in North Korea. Though

economically small, these tourist areas allowed access to sacred sites and helped families reunite. Cooperation phases would then expand to include large scale infrastructure investment, energy cooperation and joint natural resource development.<sup>30</sup> Tactically, Kim Dae-jung planned to combine two business methods: consignment processing and special economic zones. Under consignment processing, “firm A gives firm B the production facilities, raw material, production cost, and other resources necessary for production so that the later can manufacture the products which are, in turn, handed over to the former.”<sup>31</sup>

Beneficial for both nations, Kim knew these operations to be resilient and claimed “even when the general economic exchange has been affected by the prevailing political conditions between the two Koreas, the trade through consignment processing has endured and increased.”<sup>32</sup> Combining a resilient, consignment process in a free economic trade zone protected the businesses from political turmoil and maximized incentives for domestic and foreign investment.<sup>33</sup> With minimum government interference, technical experts were to manage the special economic zones in accordance with functionalist theory. Kim Dae-jung hoped that by implementing the first three functionalist tenets, Korea could realize the fourth tenet and functionally align Korean loyalties.

In 1998, Kim Dae-jung was elected president and Kim, Jong-il had been DPRK leader for four years. Following a decade of negative growth, North Korean economic decline had softened the North Korean people’s loyalty. Additionally, Kim Jong-il’s new leadership faced threats from a severely dysfunctional economy. He needed to bolster the North Korean economy and by extension his legitimacy. Kim, Jong-il was receptive to Kim, Dae-jung’s plan. The “Sunshine Policy” leveraged North Korea’s vulnerability and created a win-win scenario for each leader. North Korea gained much needed capital, technology, labor utilization and foreign

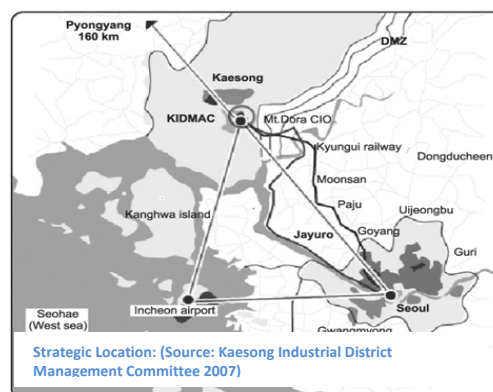
investment while developing its natural resources.<sup>34</sup> South Korea accessed cheap factors of production and hoped to reduce the eventual cost of reunification by improving the North Korean economy.<sup>35</sup> South Korea planned cooperation as a way to nudge North Korea toward a market economy and democratic social reform.<sup>36</sup>

### **The Kaesong Industrial Complex**



The Kaesong Industrial Complex embodies Kim, Dae-jung's plan. Begun in 1998, the Hyundai Group developed a joint business opportunity under the auspices of the Republic of Korea's (ROK) "Sunshine Policy."<sup>37</sup> It is located in Kaesong, North Korea which holds symbolic significance as both the ancient capital of the Koryo dynasty during the years 918-1392<sup>38</sup> and as the first site for armistice negotiations to end the Korean War.<sup>39</sup> In 1953, as war continued around Kaesong, the Korean People's Army and the Chinese government agreed to establish a Kaesong neutral zone to which both combatants would have access.<sup>40</sup> The US/ROK negotiators tried to regain Kaesong for its strategic, military importance and its strong symbolic status as the old Korean capital.<sup>41</sup> In so doing, the United States advocated for a "united, independent and democratic Korea" to be achieved by "political, as distinguished from military means."<sup>42</sup> Faced with military stalemate in 1953, the war ended with hope for a political solution. Today Kaesong represents a continued effort to secure a united, independent and democratic Korea to be achieved by economic, as distinguished from political means. This is the essence of functionalism.

Strategically located in proximity to the port of Incheon, Kaesong is 106 miles southeast of Pyongyang and 43 miles north of Seoul.<sup>43</sup> Hyundai originally



planned development in three phases beginning in 2002 with 300 ROK firms and 100,000 DPRK workers then expanding to 1500 ROK firms employing 350,000 DPRK workers in 2012.<sup>44</sup> By 2006, 1,800 companies had applied for KIC entry clearance. Despite the original Hyundai development plan, only 93 South Korean companies operated in the KIC at the end of 2008 employing roughly 39,000 North Korean workers.<sup>45</sup> By most estimates, value creation through the combination of South Korean capital and the North's cheap labor and land will stimulate increasing ties between the North and the South. The elements of production are planned to merge on a "massive scale, stimulating inter-Korean economic cooperation and bringing substantial economic benefits to both sides;"<sup>46</sup> which will ultimately stimulate business revenue and facilitate reunification costs.<sup>47</sup> Roughly half of the firms were industrial manufacturers with the rest comprising textiles and garment production.<sup>48</sup> Primarily, small to medium sized businesses are attracted to the KIC for cheap labor and reduced manufacturing costs as an alternative to other low wage markets.<sup>49</sup> South Korean companies operating in the KIC receive incentives from the ROK government and have special rights established by negotiated agreements.<sup>50</sup>

The KIC is a duty free, special economic zone with no restrictions on using foreign currency or credit cards and does not require entry or exit visas. Developers have property rights and workers are subject to home country jurisdiction. South Korean firms operating in the KIC also receive low-rate loans from the ROK



government with 25 of the 26 initial companies to invest in the KIC applying for loans from the Inter-Korea Cooperation Fund.<sup>51</sup> South Korea also provides political risk insurance that indemnifies investors up to 90% of their investment.<sup>52</sup> As one of four North Korean special economic zones, the Kaesong Industrial Complex is unique because the other three zones have become dysfunctional.<sup>53</sup>

All products made in the KIC are sold in or exported from South Korea.<sup>54</sup> Rules allow only North Korean land, labor and construction materials into the KIC with no KIC products being sold in North Korea.<sup>55</sup> After the first five years, economic viability is questionable for KIC companies.<sup>56</sup> Have politics sustained the KIC? The reason for Kaesong's continued operation may be lower labor costs inside the KIC special economic zone than in China and Vietnam and the fact that nearly 40% of ROK businesses in China have failed.<sup>57</sup>

Politics shape the KIC. Korean political leaders negotiated the KIC's development with the final construction agreement involving the private firm Hyundai Asan and two political committees: North Korea's Asian-Pacific Peace Committee and the National Economic Cooperation Association.<sup>58</sup> Development began as private enterprise, but both South and North Korean governments became involved early to provide financial backing and stimulate business. Politics continued when Hyundai Asan yielded some rights to the Korea Land Corporation and when the ROK Ministry of Unification had to finally approve the site developers.<sup>59</sup>

Despite heavy political influence, the KIC rapidly grew into a functional tie between the Koreas. The first agreements capitalized on Kaesong's strategic location by linking railways and roads while facilitating border passage, customs clearance and relaxing quarantines.<sup>60</sup> Kaesong's proximity to the border also allows South Korean electricity to completely power the KIC.<sup>61</sup> North Korean workers produce the goods while South Koreans supervise through an

“Industrial Complex Management Organization.” Negotiated agreements established minimum monthly wages although the North Korean workers earn less than their Chinese and Vietnamese counterparts (\$57 per 48hr work week vs. \$100-\$200 per 44hr work week).<sup>62</sup> Special rules exist to allow KIC companies to contract with North Korean agencies and businesses to acquire raw materials, process commissions and sell products.<sup>63</sup> KIC companies also receive special tax rates. For example, “promoted businesses” that operate in the KIC for 15 years are exempt from corporate income tax during their first five, profitable years.<sup>64</sup> Additionally, companies pay between 10% and 14% corporate income tax to North Korea, a slightly cheaper rate than companies operating in Chinese special economic zones.<sup>65</sup> Although real estate is 33% more expensive in Kaesong than in Dandong, China,<sup>66</sup> these special benefits outweigh the KIC operating costs.

When fully developed, the KIC should provide approximately 100,000 jobs and produce an astounding 3% of South Korean gross national income.<sup>67</sup> The KIC helps South Korean small and medium sized businesses cut costs dramatically without shrinking the overall number of South Korean business. Companies that moved or invested in the KIC between 2004 and 2011 did not negatively impact the South Korean economy.<sup>68</sup> However, Kaesong’s business and political potential remains in jeopardy.

North Korean restrictions hamper relocating production facilities to the KIC while additional South Korean, North Korean and international trade restrictions further limit commercial activity. Major electronics, information technology and other international strategic goods as classified by the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-use Goods and Technologies are restricted, too.<sup>69</sup>

High tariffs plague the KIC. For example, the US tariff rate is on neckties made in North Korea is 65% versus 7% on neckties made in other countries.<sup>70</sup> Protectionist laws and institutional devices have failed to adequately promote KIC economic cooperation. In addition, money from the Inter-Korean Cooperation Fund ebbs and flows based on resources and political direction.<sup>71</sup> Politicians continue to bristle at North Korea's potential to gain technology and foreign investment by highlighting this venture as an "open-door" image.<sup>72</sup> Despite these concerns, accessing North Korean markets may bridge South Korea to Chinese and Russian markets. While South Korean-Chinese-Russian diplomatic relations have been established for some time, the commercial relationships have room to improve.<sup>73</sup> Tightly entwining North and South Korean business at the KIC facilitates Korean unification; and, the KIC yields important peace dividends due to its proximity to the military demarcation line.<sup>74</sup>

#### **Functionalist Fruit**

A business bastion, Kaesong generates benefits in five non-business areas: resiliency, human rights, legal reform, free trade and political change. More than generating economic gain, functionalism can serve as an engine for social change. Regardless of function, cooperation requires discussion and compromise on issues that might otherwise be impossible. In Kaesong, non-governmental organizations have new access to debate human rights claims on behalf of thousands of North Korean workers. Money lending institutions suddenly clamor for fund transparency and accountability. Continued business investment and viability remains tied to human rights, labor relations, accountability and transparency inside the KIC. These concerns drive legal reform which in turn improves business conditions and strengthens security between the two nations. This improved security enables free market changes and increased trade which



then leads to further legal reforms creating a cyclical pattern of social reform. However, only the strongest relationships survive controversial social reform.

### **The KIC is Resilient**

Touchy subjects like human rights, legal reforms and trade require solid ground for debate. The relationship must be worth more than the divisive issue. Kaesong delivers such a resilient partnership. KIC operations continue during crises and provide a security dividend for Korea and by extension to their allies. The Korean Cold War softens in Kaesong from military confrontation to solving joint economic problems. Establishing the KIC presupposed the two partners would work well together; or, that perhaps the potential economic gains would be enough to induce political, management or cultural change. The KIC mitigates Korean conflict, but has room for improvement.

Kaesong's governance must be strengthened to enhance its international credibility.<sup>75</sup> The KIC withstood North Korean threats, nuclear weapons tests and missile launches. Kaesong also remained open after the North sunk the ROK warship "Cheonan" and South Korea severed all other ties with North Korea. North Korea needs the money generated by Kaesong. South Korea believes their business "outpost in the North," while economically viable, also remains subversive to the DPRK regime and will lead to unifying the two Koreas.<sup>76</sup> The Kaesong commitment enables human rights improvements and models how worker treatment and protection can be managed across borders.<sup>77</sup>

### **Human Rights**

Regulations governing the roughly 44,000 KIC workers do not "guarantee freedom of association, the right to collective bargaining, the right to strike, or the right of individual workers to change jobs. Nor do the regulations prohibit child labor, sexual harassment or gender



based discrimination when nearly all the workers are women between the ages of 20-30 years old.”<sup>78</sup> Furthermore, KIC regulations mandate the workers to be paid their monthly salary both in cash and in US dollars. Yet, the employers have been forced to pay it to the North Korean government with no accountability of where the money actually went.<sup>79</sup>

Since 2006, Human Rights Watch documented human rights deficiencies in North Korea and has asked South Korea to pressure North Korea to join the International Labor Organization (ILO), adhere to the ILO’s standards, and implement the Organization for Economic Cooperation and Development’s (OECD) Guidelines for Multinational Enterprises.<sup>80</sup> Greater UN and NGO interest in Kaesong spreads the functionalist web.

Human rights advocates suggest more KIC monitoring and establishing a special inter-Korean court with jurisdiction over Kaesong.<sup>81</sup> Such claims, however, leave North Korea wary of South Korean subversion and lead to increased DPRK resistance to a supranational legal regime in Kaesong.<sup>82</sup> In fact, such an adversarial approach to human rights enforcement in Kaesong will probably not work.

The existence of this joint enterprise has opened new social science and pseudo-political discussions between the two Koreas. Efforts to secure human rights within a political community can’t happen in a vacuum. Even on a small scale like the KIC, key actors must articulate claims to human rights and have the willingness of political power brokers to “account for these claims by enacting laws and shaping policies.”<sup>83</sup> In this nexus of public and private life, we see the engine of functionalism in action. Such an environment exists in Kaesong where the Kaesong Industrial Complex Management Committee and the North Korean General Bureau can work together to maintain an acceptable level of human rights.<sup>84</sup> Better labor standards

derived from legal reform is crucial to Kaesong's ability to attract foreign investment and remain sustainable.

### **Legal Reform**

Properly implementing legal reforms in this special economic zone encourages foreign direct investment. Recently, concern for North Korean workers generated interest in the legality of third party advocacy for North Korean workers in the KIC. Attempting to apply a common legal framework to Kaesong expands the functional connection between South and North Korea. An excellent discussion by Lavanga Wijekoon in the Pacific Rim Law & Policy Journal distilled the complexity of pursuing a legal solution to human rights violations in Kaesong.

Beginning with the idea that Korean peace and prosperity are paramount to reunification, labor violations in Kaesong must be resolved because they tarnish the KIC as a symbol of inter-Korean cooperation.<sup>85</sup> The US estimates up to 45% of KIC workers' wages are expropriated by the North Korean government.<sup>86</sup> Yet, what recourse do the KIC workers have? International guidelines from the ILO and the OECD, both of which South Korea is a member, direct but, do not require South Korean companies in the KIC to protect North Korean workers' rights.<sup>87</sup> As an OECD member, South Korea must ensure its corporations respect international labor standards regardless if the companies reside in North Korea and employ North Korean workers.<sup>88</sup>

Furthermore, the ILO requests that South Korean courts recognize worker's rights in the KIC. In fact, it is possible for North Korean workers to bring an equal protection claim seeking redress and protection in South Korean Constitutional Court.<sup>89</sup> Vague citizenship definitions persist from the Korean War which allow South Korean rights for North Koreans. For example,

South Korean courts have extended South Korean nationality to North Koreans partly because South Korea doesn't recognize North Korea as a legitimate nation.<sup>90</sup> In fact, the South Korean vice Unification Minister stated that those who have committed crimes in North Korea may be held responsible in South Korea.<sup>91</sup> So as de jure citizens of South Korea, North Korean workers could bring a suit in the South Korean Constitutional Court seeking redress for violations of the equal protection clause of the South Korean constitution.<sup>92</sup>

Wijekoon argues that since the "soft laws" of the ILO and OECD do not compel action, it's important to claim a legal duty for the South Korean government to recognize and protect the rights of North Korean workers. Such action would, in turn, compel the government to hold accountable South Korean corporations operating in Kaesong through stricter regulations and sanctions.<sup>93</sup> In addition, Wijekoon admits that the "soft law" principles found in the ILO and OECD charters should be used in any labor rights suits to "bolster the persuasive effect of these non-binding guidelines."<sup>94</sup>

Practically though, how would North Korean workers leave North Korea to pursue a legal case in South Korea? And, what about South Korean laws that prohibit third party and anonymous labor relations law suits? Legal reforms are necessary to model South Korean law after transnational litigation norms that would permit holding Kaesong corporations accountable by lawsuit for labor violations. South Korea could also relax litigation standing requirements to allow third-party lawsuits on behalf of the North Korean workers, extend court jurisdiction to hear extraterritorial constitutional claims against domestically owned corporations, and follow a US model that allows litigants to maintain anonymity in labor rights cases.<sup>95</sup> As if to underscore the functional connection to legal reform, Wijekoon concludes "if unification of the two Koreas is South Korea's ultimate goal in building a peace regime through inter-Korean cooperation, then

South Korea must see all Koreans as equal and extend to North Koreans the rights currently granted to South Koreans.”<sup>96</sup>

In addition to legal reform, political regulation and shareholder pressure represent two important sources of leverage within Kaesong. Whether not fully paying North Korean workers, expecting the workers to work unpaid overtime or barring formal labor unions, publicly revealing these labor rights claims resulted in the US labeling the KIC workers “trafficking victims,” and caused bold accusations that South Korea economically supports Kim, Jong-Il’s repressive regime.<sup>97</sup> Legal reform enhances investment security by improving workers’ rights, transparency and accountability. The improved security attracts foreign investment and enables market reforms and free trade.

### *Free Trade*

For Kaesong to be an internationally competitive special economic zone, both Korea’s planned the development to attract many foreign companies that would bring state-of-the-art technology. The original Kaesong agreement between Hyundai and North Korea expected the KIC to be a complex for international exports.<sup>98</sup> Seoul has announced a committee to promote foreign investment in Kaesong and the Kimberly-Clark Corporation has held meetings with the Hyundai Asan Company, the Ministry of Unification and other parties to discuss possible investment opportunities.<sup>99</sup> But, US business has not yet entered the KIC. US foreign direct investment in the Kaesong Industrial Complex is far from certain and complicated by a variety of US sanctions on North Korea.

Both South Korea and the US hope to expand economic cooperation by signing a free trade agreement to reduce trade barriers.<sup>100</sup> In 2006, the US and South Korea began serious deliberations on a Korea-United States Free Trade Agreement (KORUS FTA). These FTA

negotiations continue over properly characterizing products made by the KIC.<sup>101</sup> South Korea insists that KIC goods be labeled “Made in Korea” which gives these products preferential trade status.<sup>102</sup> “Made in Korea” precedent exists for KIC products. A trade agreement between South Korea, ASEAN and the European Free Trade Association allows labeling KIC products “Made in Korea.”<sup>103</sup>

Optimistically, South Korea believes this label can stabilize the peninsula and facilitate eventual unification. The US, on the other hand, prefers to exclude the KIC from the FTA for a variety of reasons including: North Korean human rights violations, exploited worker claims, the potential to funnel money to Pyongyang, North Korea counterfeiting US currency and nuclear proliferation.<sup>104</sup>

KIC administrators and technocrats now argue about applying World Trade Organization (WTO) rules of origin to the KIC. Using the rules of origin to label KIC products “Made in Korea” subverts US economic leverage on North Korea by weakening trade sanctions and allowing goods made by North Korean labor unprecedented access to international markets.<sup>105</sup> Further, including KIC goods in the FTA would mean more foreign funds for North Korea, thereby supporting and prolonging a corrupt regime. Separate revenue, however, could reduce North Korea’s need to proliferate weapons and nuclear technology to terrorists for cash.<sup>106</sup> Both the US and South Korea employ a comprehensive embargo against North Korea because it is an official state sponsor of terrorism.<sup>107</sup> According to the Yale Law Journal, the KIC provides a new way for the international community to deal with North Korea. However, the WTO rules of origin may allow North Korean goods to bypass high tariff barriers and sanctions.<sup>108</sup>

### *Political Changes*

Kaesong occupies the center of Korean economic and geopolitical drama and presents the US with a policy dilemma. It provides the DPRK with more money, but according to the Congressional Research Service, it also “provides a possible beachhead for market reforms in the DPRK that could eventually spill over to areas outside the park and expose tens of thousands of North Koreans to outside influences and incentives.”<sup>109</sup> Growing the KIC expands the dilemma. While officially supporting the KIC, the main US exposure to Kaesong occurs with the KORUS FTA and the potential ramifications of including the KIC as an outward processing zone (OPZ).<sup>110</sup> If the KIC is allowed to be an OPZ for Korean goods, South Korean exporters would gain a large cost advantage when competing with their US counterparts.<sup>111</sup>

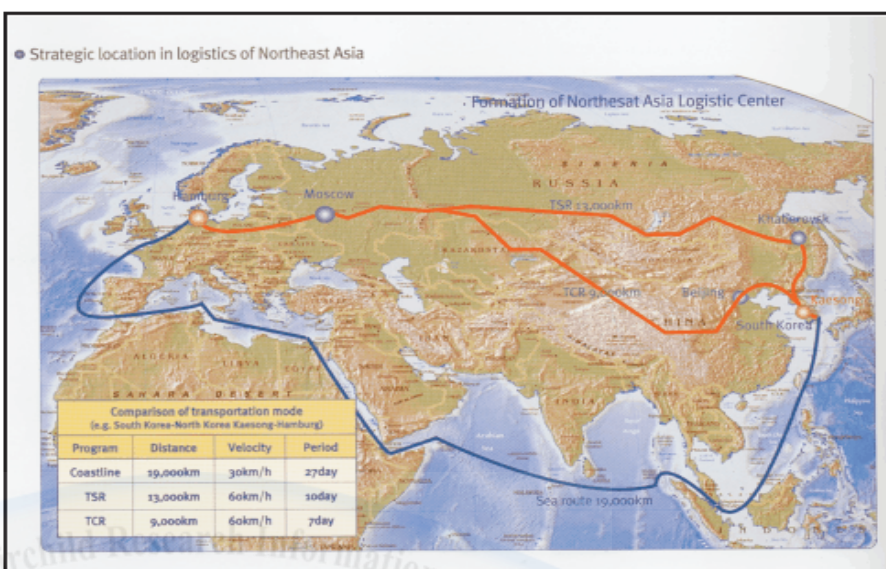
Tactically, the KIC is just a business venture. Operationally, the KIC provides a channel for reconciliation and unification between South and North Korea whereby successful cooperation could increase trust and reduce hostility. Strategically, Kaesong represents an attempt to “reform, liberalize, and modernize the North Korean economy.”<sup>112</sup> North Korea’s use of special economic zones, like China, exposes the country to market economy benefits which could lead to greater affinity towards the West.<sup>113</sup> Kaesong is a controversial geopolitical pawn in the standoff between North Korea, its regional neighbors and the US because it increases security and delays dismantling North Korea’s nuclear program. Unfortunately, any financial benefit to the DPRK, even through the KIC, undermines the greater US strategic goal.<sup>114</sup>

South Korea’s strategic goals, however, include unification. South Korea hopes to use the KIC to alleviate unification costs and avoid an impact like West Germany experienced when integrating East Germany.<sup>115</sup> Comparing the US and South Korean strategies, South Korea is “longer on carrots (promises of food, fuel, and fertilizer) and shorter on the sticks (sanctions)



with a heavy reliance on engagement.”<sup>116</sup> Beyond unification, South Korea plans to be an East Asian logistics hub. A North-South Korean rapprochement greatly improves South Korea’s access to Europe by rail.<sup>117</sup> By connecting to the trans-China or trans-Siberian railroads, South Korea could save two to three weeks when transporting goods to Europe (see figure at right).

Kaesong faced challenges after the 2007 South Korean election of Lee, Myung-bak. South Korean policy changes limited



Shipping vs. Trans-China & Trans-Siberian Railroads to Europe (Source: Congressional Research Service)

advances made during the “Sunshine Policy.” In response, North Korea tightened border control with South Korea and in December, 2008 suspended cross-border rail service, cancelled South Korean sightseeing tours to Kaesong and closed the only inter-Korean economic office in Kaesong.<sup>118</sup> North Korea leveraged Kaesong to accomplish three objectives: first, to pressure South Korea to revise its policy with the North and to make North Korea a top priority for the US; second, to assert the North Korean military’s influence in controlling the country; and third, it served as an attempt to incite conflict between the US and South Korea.<sup>119</sup> Politics often supersedes function at the KIC.

Effective US policy in Kaesong must balance the three guidelines that shape US international policy: security, economic well being and value projection.<sup>120</sup> Kaesong helps US security interests by stabilizing the DMZ, but concerns remain about funding the DPRK. UN

Security Council Resolution 1718 explicitly prohibits a member state from supporting North Korea's nuclear weapons program, but revenue from Kaesong could be funneled to the North Korean military.<sup>121</sup> Economically, no US companies operate in the KIC. However, the KORUS FTA remains important. If the FTA excludes Kaesong as an outward processing zone, KIC companies will likely avoid the US market due to high tariff rates.<sup>122</sup> Finally, Kaesong is an excellent venue to showcase US values in a market based economy while tackling labor rights issues, human rights claims and free trade legalities. Perhaps, cultural spillover will mollify political division and lead to unifying Korea.<sup>123</sup>

### **Conclusion**

In theory and practice, functionalism is useful when building foreign policy. Using functional international relations theory, Kim Dae-jung built a plan for unifying Korea; and once elected president, he established a political strategy that engaged North Korea functionally while minimizing political friction. The Kaesong Industrial Complex is growing and continues to be a resilient enterprise despite shifting political pressures. Kaesong creates tangible benefits for the people, businesses and governments of both South and North Korea.

Engaging North Korea functionally, while untenable to some, enables strategic progress in human rights, legal reform, free trade and political change that otherwise would have been impossible. Rather than utterly crushing an enemy, functionalism keeps the dream of Korean unification alive.

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<sup>1</sup> Ernst B. Haas, *Beyond the Nation-State: Functionalism and International Organization*, Stanford, CA: Stanford University Press, 1964, 8.

<sup>2</sup> Jennifer A. Marshall and Grace V. Smith, "Human Rights and Social Issues at the U.N." *Reclaiming the Language of Freedom at the United Nations: A Guide for U.S. Policymakers*, Heritage Special Report SR-8, Washington, DC: The Heritage Foundation, September 2006, 33-34.

<sup>3</sup> Ernst B. Haas, *Beyond the Nation-State: Functionalism and International Organization*, Stanford, CA: Stanford University Press, 1964. 9.

<sup>4</sup> Ibid.



<sup>5</sup> Ibid.

<sup>6</sup> Ibid. 10.

<sup>7</sup> Ibid.

<sup>8</sup> Ibid.

<sup>9</sup> Ibid. 11.

<sup>10</sup> Ibid.

<sup>11</sup> Ibid. 12.

<sup>12</sup> Ibid. 21-22 & 47.

<sup>13</sup> Ibid. 47.

<sup>14</sup> Kim, C.I. Eugene, ed., *Korean Unification: problems and prospects*, Kalamazoo, MI: The Korea Research and Publications, Inc., 1973, I-1.

<sup>15</sup> Ibid. I-1.

<sup>16</sup> Byung, Ho-park, "Natural Resources and Industrial Location in South and North Korea," In *Korean Unification: problems and prospects*, Edited by C.I. Eugene Kim, pp. II7-II38, Kalamazoo, MI: The Korea Research and Publications, Inc., 1973, II7-II28.

<sup>17</sup> Ibid. II28.

<sup>18</sup> Ibid.

<sup>19</sup> Ibid, I-3.

<sup>20</sup> Ibid. I-4.

<sup>21</sup> Ibid. 30.

<sup>22</sup> Chung, Joseph Sang-hoon, "North Korea's Economic System and Development: Recent Trends and Their Implications on Unification," In *Korean Unification: problems and prospects*, Edited by C.I. Eugene Kim, Pp. II7-II38, III52.

<sup>23</sup> Ibid. III55.

<sup>24</sup> Ibid. III57.

<sup>25</sup> Ibid. II32.

<sup>26</sup> Ibid.

<sup>27</sup> Kim, Dae-Jung, "Three-Stage" Approach to Korean Reunification: Focusing on the South-North Confederal Stage, The Center for Multiethnic and Transnational Studies, Los Angeles, CA: 1997, 14-15.

<sup>28</sup> Ibid. 119.

<sup>29</sup> Ibid. 120.

<sup>30</sup> Ibid. 155.

<sup>31</sup> Ibid. 167.

<sup>32</sup> Ibid. 168.

<sup>33</sup> Ibid. 169.

<sup>34</sup> Ibid. 128.

<sup>35</sup> Ibid. 129.

<sup>36</sup> Ibid. 131.

<sup>37</sup> Dick K. Nanto and Mark E. Manyin, *The Kaesong North-South Industrial Complex*, Congressional Research Service, Washington, DC: June 2010, 5.

<sup>38</sup> Hans Schattle, "Human Rights, Transparency and Transborder Collaboration in Korea: The Case for a Deliberative Approach at the Kaesong Industrial Complex," *Pacific Focus*, Vol. XXV, No. 3 (December 2010), pp. 417-438, 419.

<sup>39</sup> Donald W. Boose, "The Korean War Truce Talks: A study in conflict termination," *Parameters*, vol. 30, no. 1 (Spring 2000) pp. 102-116, 103.

<sup>40</sup> Ibid.

<sup>41</sup> Ibid. 107.

<sup>42</sup> Ibid, 106.

<sup>43</sup> Nanto, 5.

<sup>44</sup> Ibid. 6.

<sup>45</sup> Kim, Suk-hi and Lim, Eul-chul, "The Kaesong Inter-Korean Industrial Complex: Perspectives and Prospects," *North Korean Review*, Vol. 5, No. 2 (Fall 2009), pp. 81-92, 81.

<sup>46</sup> Park, Suhk-sam, "Creating a Visible Bridge: The Economic Impact of Kaesong Industrial Complex Construction," *East Asian Review*, Vol. 16, No. 3 (Autumn 2004) pp. 87-104, 87.

<sup>47</sup> Ibid.

<sup>48</sup> Nanto, 6.

<sup>49</sup> Ibid.

<sup>50</sup> Nanto, 5.

<sup>51</sup> Ibid.

<sup>52</sup> Ibid.

<sup>53</sup> Kim and Lim, 81.

<sup>54</sup> Nanto, 7.

<sup>55</sup> Ibid.

<sup>56</sup> Ibid.

<sup>57</sup> Ibid. 8.

<sup>58</sup> Park, 88.

<sup>59</sup> Ibid. 89-90.

<sup>60</sup> Ibid. 90.

<sup>61</sup> Seok-Yoon, "An Economic Perspective of Kaesong Industrial Complex in North Korea," *American Journal of Applied Sciences*, Vol. 4, No. 11 (2007), pp. 938-945, 940.

<sup>62</sup> Ibid.

<sup>63</sup> Ibid.

<sup>64</sup> Park, 92.

<sup>65</sup> Seok, 940.

<sup>66</sup> Park, 92.

<sup>67</sup> Ibid. 101.

<sup>68</sup> Ibid. 103.

<sup>69</sup> Seok, 940.

<sup>70</sup> Ibid.

<sup>71</sup> Ibid.

<sup>72</sup> Ibid. 943.

<sup>73</sup> Ibid. 944.

<sup>74</sup> Seok, 940.

<sup>75</sup> Schattle, 417.

<sup>76</sup> Schattle, 418.

<sup>77</sup> Ibid.

<sup>78</sup> Ibid.

<sup>79</sup> Ibid. 419.

<sup>80</sup> Ibid. 424.

<sup>81</sup> Ibid. 425.

<sup>82</sup> Ibid. 426.

<sup>83</sup> Ibid. 421.

<sup>84</sup> Ibid. 428.

<sup>85</sup> Lavanga V. Wijekoon, "Litigating Labor Rights Across a Demilitarized Zone: The South Korean Constitutional Court as a Forum to Address Labor Violations in North Korea's Kaesong Special Economic Zone," *Pacific Rim Law & Policy Journal*, Vol. 17 (January 2008) pp. 265-294, 267.

<sup>86</sup> Ibid. 269.

<sup>87</sup> Ibid.

<sup>88</sup> Ibid. 272.

<sup>89</sup> Ibid.

<sup>90</sup> Ibid. 274.

<sup>91</sup> Ibid.

<sup>92</sup> Ibid.



- <sup>93</sup> Ibid.
- <sup>94</sup> Ibid. 279.
- <sup>95</sup> Ibid. 279-288.
- <sup>96</sup> Ibid. 292.
- <sup>97</sup> Ibid, 265.
- <sup>98</sup> Lim, Eul-chul, "Legal Reforms and Foreign Investment in the Inter-Korean Project: The Kaesong Industrial Complex," *North Korean Review*, Vol. 4, No. 1 (Spring 2008), pp. 26-39, 30.
- <sup>99</sup> Ibid.
- <sup>100</sup> Kim, Suk and Hassan Moussawi, "A Proposed Korea-U.S. Free Trade Agreement and Kaesong Industrial Complex," *North Korean Review*, Vol. 3, No. 1 (Spring 2007), pp. 59-71, 60.
- <sup>101</sup> Ibid.
- <sup>102</sup> Ibid, 68.
- <sup>103</sup> Ibid.
- <sup>104</sup> Ibid.
- <sup>105</sup> Daniel J. Knudson & William J. Moon, "North Korea and the Politics of International Trade Law: the Kaesong Industrial Complex and WTO Rules of Origin," *The Yale Journal of International Law*, Vol. 35. No. 1, pp. 251-256, 255.
- <sup>106</sup> Ibid.
- <sup>107</sup> Nanto, 14.
- <sup>108</sup> Knudson. 256.
- <sup>109</sup> Nanto, 4.
- <sup>110</sup> Nanto, 5.
- <sup>111</sup> Ibid. 14.
- <sup>112</sup> Ibid. 15.
- <sup>113</sup> Ibid. 16.
- <sup>114</sup> Ibid.
- <sup>115</sup> Ibid.
- <sup>116</sup> Ibid. 16.
- <sup>117</sup> Ibid. 17.
- <sup>118</sup> Kim and Lim, 84.
- <sup>119</sup> Ibid. 85.
- <sup>120</sup> Nanto, 18.
- <sup>121</sup> Ibid. 18.
- <sup>122</sup> Ibid. 19.
- <sup>123</sup> Ibid. 19.



**APPENDIX A**  
**Potential Further Research**

Functionalist international theory lends itself to further research. When writing this report, several questions arose that may become future topics for reports on functionalism.

1. Does functionalism threaten US national security?
  - a. The administrative state required by functionalism undermines the US foundation for civil society (faith, family, free association). Liberty abridged by functional administration.
  - b. “The internationalization of the administrative state has merely opened a new front for political conflict among nations.”<sup>124</sup> How?
  - c. Internationalization of administrative state antithetical to American liberty
  - d. National security in defending civil society? Preserving constitutional authority over administrative government.
2. Why are functional international relationships resilient? Does self interest alone sustain functionalism?
3. When is functionalism successful? Or, when does it produce the best results?
4. What attributes best contribute to functional international relations?
  - a. Homogenous culture? (i.e. North/South Korea; East/West Germany; US Civil War reconstruction; China/Taiwan versus Western Culture in Middle East, Asia or Africa?
  - b. Does functionalism rely more on the social science concept of “gemeinschaft” whereby community mores achieve prominence over the individual versus

“gesellschaft” where self-interest has priority in a community, i.e. a modern business community. How does this relate to integration?

5. Is functionalism better for unifying divided countries or conquering empire? Intra-state vs. Inter-state?

6. What are the limits of functionalism? Discussion of “universal” human rights.

Human Rights: Individual Rights vs. Social Rights: inventing functional relationships for ulterior motives.

7. What geopolitical conditions best support functionalism?

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<sup>124</sup> Jennifer A. Marshall and Grace V. Smith, “Human Rights and Social Issues at the U.N.,” *Reclaiming the Language of Freedom at the United Nations: A Guide for U.S. Policymakers*, Heritage Special Report SR-8, Washington, DC: The Heritage Foundation, September 2006, 34.



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